Supreme Court, U.S.
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No. 91-552

In the Supreme Court of the United States

OCTOBER TERM, 1991

RONALD COLEMAN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether petitioners established that they possessed a depreciable interest in certain business equipment and whether penalties asserted by the Commissioner were properly upheld.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	1
Argument	5
Conclusion	7

TABLE OF AUTHORITIES

Cases:

Coleman v. *Commissioner*:	
87 T.C. 178 (1986)	2, 3, 4, 6, 7
833 F.2d 303 (3d Cir. 1987)	3
Commissioner v. *Danielson*, 378 F.2d 771 (3d Cir.), cert. denied, 389 U.S. 858 (1967)	6
Commissioner v. *Sunnen*, 333 U.S. 591 (1948)	5
Cory v. *Commissioner*, 159 F.2d 391 (3d Cir. 1947)	5
Frank Lyon Co. v. *United States*, 435 U.S. 561 (1978)	6
Helvering v. *F. & R. Lazarus & Co.*, 308 U.S. 252 (1939)	6

Statutes and regulation:

Internal Revenue Code (26 U.S.C.):	
§ 6621(c)	4, 5
§ 6659	4, 5
§ 6661	4, 5
§ 6661(b)(2)(B)(ii)	5
Treas. Reg. § 1.6661-3	5

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OPINIONS BELOW

The judgment order of the court of appeals (which issued no opinion) (Pet. App. A15) is unpublished, but is noted at 935 F.2d 1280 (Table). The Tax Court's memorandum opinion (Pet. App. A1-A14) is reported at 58 T.C.M. (CCH) 125 (1989).

JURISDICTION

The judgment of the court of appeals was entered on May 22, 1991. The petition for a writ of certiorari was filed on August 15, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners are partners in Majestic Construction Company, a New Jersey partnership. In 1979, Majestic entered into a transaction with Atlantic

Computer Leasing p.l.c., a United Kingdom corporation that acted as a supplier of configured computer systems. Atlantic primarily supplied equipment to its customers through "arranged leases." In these transactions, a third party received title to the equipment, the right to collect rent from Atlantic's customers for a fixed period and, under British law, the right to deduct immediately the cost of the equipment. In return, the formally-designated lessor paid Atlantic a sum that generally equalled the present value of the lease payments the lessor would receive over the term of the lease. Atlantic retained a "residual interest" in the equipment in the form of an option to repurchase the equipment for a nominal amount upon the completion or early termination of the arranged lease. Atlantic used its "residual interest" in one of two ways. Atlantic would sometimes exercise its repurchase option and refurbish the equipment, which it would then sell or lease to a new user. Alternatively, Atlantic would enter into a "forward sale" in which it sold its residual interest to an American investor, who obtained the right to participate in the profits Atlantic obtained from remarketing the equipment. See Pet. App. A4-A6; *Coleman* v. *Commissioner*, 87 T.C. 178, 179, 182-184 (1986).

The transaction between Atlantic and Majestic involved a series of assignments of Atlantic's residual interests in eight leases. The leases state that the formally-designated lessor is the lawful owner of the equipment and has the right to repossess the equipment in the event of a lessee default. Each lessor's residual agreement with Atlantic conditioned Atlantic's exercise of its repurchase option upon the lessor's receipt of all monies due either under the lease or under an agreed, early termination settle-

ment. See Pet. App. A6; *Coleman* v. *Commissioner*, 87 T.C. at 180-183 & n.5, 205-206.

Atlantic's residual interest under these leases was transferred to two successive intermediate leasing corporations, European Leasing Ltd. and Carena [Computers] B.V. Thereafter, the residual interest was assigned from Carena to Majestic for a consideration of $2,055,553, consisting largely of a nonrecourse note. *Coleman* v. *Commissioner*, 87 T.C. at 191-193, 207.[1] Concurrently with the execution of Carena's assignment to Majestic, Majestic leased its interest in the equipment back to Carena until 1990 for an amount that equalled the nonrecourse debt payments Majestic agreed to pay Carena. *Coleman* v. *Commissioner*, 87 T.C. at 195-196.

2. The present case involves petitioners' 1981 through 1985 tax years and is the second case in which petitioners claimed deductions for depreciation and interest indebtedness arising from Majestic's transactions with Atlantic. The first of these two cases, *Coleman* v. *Commissioner*, 87 T.C. 178 (1986), aff'd, 833 F.2d 303 (3d Cir. 1987) (*Coleman I*), involved petitioners' 1979 and 1980 tax years. In *Coleman I*, the Tax Court sustained the Commissioner's disallowance of the depreciation and interest deductions petitioners claimed on their 1979 and 1980 tax returns. The court found that Atlantic (and hence Majestic, as the successor to Atlantic's interest) did not have a depreciable interest in the equipment that was the subject of the leases. The court reasoned that

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[1] In analyzing the effect of these transactions, the Tax Court ignored the intervention of European and Carena and assumed that the sale and leaseback was effectively between Atlantic and Majestic. *Coleman* v. *Commissioner*, 87 T.C. at 201 n.16.

Atlantic did not possess any of the benefits and burdens of ownership of the computer equipment. *Coleman* v. *Commissioner*, 87 T.C. at 206-207.

Petitioners stipulated in this case (Pet. App. A4) that, with certain minor additions, the record in this case was limited to the record compiled in *Coleman I*. Petitioners also stipulated that the only issues presented by this case were (i) their entitlement in 1981 through 1985 to deductions for depreciation on the rights they had acquired from Atlantic and (ii) their liability for additions to tax under Sections 6659, 6661 and 6621(c) of the Internal Revenue Code (26 U.S.C.). Pet. App. A3-A4.

3. The Tax Court sustained the deficiencies and additions to tax for petitioners' 1981 through 1985 taxable years. Petitioners argued that the situation in this case differed from that in *Coleman I* because Atlantic had exercised its repurchase options during the years this case involves. The court rejected this contention because petitioners had not proven that Atlantic had, in fact, acquired ownership of the equipment by exercising the repurchase options. The court noted that it "strain[ed] credibility to believe that petitioners could have brought a case from petition to reply brief * * * without providing the very piece of evidence necessary to prove their point" (Pet. App. A9).

Declining "to speculate as to what might have happened had Atlantic exercised these options" (Pet. App. A10), the court also rejected petitioners' contention that they were entitled to deduct interest on their nonrecourse note on the theory that a genuine indebtedness existed once the options were exercised. Because the value of the interest in the computer equipment claimed by petitioners exceeded its actual

value by more than 250 percent, the court found petitioners to be liable for a valuation overstatement penalty under Section 6659 and for additional interest under Section 6621(c). The court also found petitioners liable for penalties under Section 6661 of the Code for their 1982 taxable year because they failed to show that the understatement of their tax liability was supported by statutory or regulatory authority as required by Treas. Reg. § 1.6661-3, or that they had adequately disclosed their tax position as then required by Section 6661(b)(2)(B)(ii) of the Code. Pet. App. A11-A14. The court of appeals affirmed (Pet. App. A15) in an unpublished judgment order.

ARGUMENT

The courts below correctly concluded that petitioners failed to carry their burden of proving that they were entitled to depreciation and interest deductions for their 1981 through 1985 taxable years. That fact-bound determination is based on the unique circumstances of this case. The decision does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

The Tax Court correctly sustained the deficiencies and penalties asserted by the IRS for petitioners' 1981 through 1985 taxable years. Because petitioners had failed in earlier litigation to show that they had a depreciable interest in the subject equipment in 1979 or 1980, petitioners were prevented from relitigating the same facts for the 1981-1985 tax years. See *Commissioner* v. *Sunnen*, 333 U.S. 591, 601 (1948); *Cory* v. *Commissioner*, 159 F.2d 391, 392-393 (3d Cir. 1947). Petitioners therefore sought to base their claim of a depreciable interest during the 1981-1985 tax years on the new factual contention that

Atlantic had exercised its repurchase options. Petitioners bore the burden of proof on this issue. The Tax Court properly concluded that petitioners failed to offer adequate proof to meet that burden in this case. See Pet. App. A9.

Any relevance that the arguments in Part I of the petition (Pet. 10-22) might have would relate only to *Coleman I*, where petitioners maintained that Atlantic "owned" the equipment because its conveyance to the lessors was, in actuality, a security arrangement rather than a sale.[2] In this case, by contrast, petitioners contended that Atlantic owned the computer equipment because it exercised its repurchase options after the expiration of the leases. Because petitioners failed to prove the factual assertion that Atlantic had exercised these options, however, petitioners simply failed to establish any difference between the cases. Whether or not the alleged factual difference, if proven, would have called for a different result was not a question presented for decision in the court of appeals and is not presented to this Court.[3]

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[2] In *Coleman I*, the Tax Court explicitly applied the standards articulated by this Court in *Helvering* v. *F. & R. Lazarus & Co.*, 308 U.S. 252 (1939), and *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978), and considered factors other than the location of legal title to determine ownership of depreciable assets. Based on the entire record, the court found that the substance, as well as the form, of Atlantic's transaction with the British lessors was that of a sale and not a security arrangement. *Coleman* v. *Commissioner*, 87 T.C. at 201, 208.

[3] There is no support for petitioners' contention (Pet. 10-12) that the outcome of their case turned on the application of *Commissioner* v. *Danielson*, 378 F.2d 771 (3d Cir.), cert. denied, 389 U.S. 858 (1967). In holding that petitioners

Finally, petitioners' complaints concerning the penalties imposed on them (Pet. 22-24) furnish no basis for review. Petitioners' claims regarding the penalties stem from the same erroneous contention they advance with respect to the merits—that "other circuits probably would have decided [this case] in the taxpayer's favor" (Pet. 24). Petitioners' residence, however, played no role in the disposition of the factual issues presented by this case, either as to the merits or as to the penalties asserted by the Commissioner.

CONCLUSION

The petition for a writ of certiorari should be denied.

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failed to carry their burden of proof, neither the Tax Court's opinion nor the judgment order of the court of appeals even refers to the so-called *Danielson* rule. *Danielson* also played no significant role in the outcome of *Coleman I*. In its decision in that case, the Tax Court applied a multi-factor "benefits and burdens" analysis and found that Atlantic did not own the equipment that was the subject of the leases. In applying this test, the court discussed the *Danielson* rule only as it pertained to the location of title, which was but one factor among the many on which the court based its decision. See *Coleman* v. *Commissioner*, 87 T.C. at 204.

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